Testimony of
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Federal Energy Regulatory Commission

Before the
Subcommittee on Energy and Power
Committee on Commerce
United States House of Representatives
October 5, 1999

Introduction

Good morning Mr. Chairman and Members of the Subcommittee. I thank you for inviting me along with all of my fellow Commissioners to testify this morning on H.R. 2944, the Electricity Competition and Reliability Act of 1999.

I joined the Commission six and one-half years ago. The electric utility industry the Commission regulates in 1999 bears little resemblance to the industry I first encountered as a federal regulator in 1993.

Competition is now clearly the driving force leading the utility industry to restructure. Electric utilities are no longer the stodgy, conservative enterprises of earlier years, favored primarily by widows and orphans. Open access transmission and negotiated, market-based rates are in. Preferential and discriminatory access, and years'-long hearings to assess cost structures and cost allocations, are on their way out. Utility executives are increasingly entrepreneurial in spirit and action; shareholders and ratepayers increasingly are demanding decisive action to promote transaction-related revenues and to cut costs.

Utilities have responded to the advent of competition in a number of different ways. One business strategy is to concentrate on core, niche services. A number of utilities have reached the conclusion that they can best respond to competitive forces by concentrating on their "wires" business; i.e., focusing on electrical transmission and distribution. These utilities have decided to sell off their generating assets – sometimes at a price far in excess of book value, with the proceeds often going to reduce or eliminate their exposure to uneconomic or "stranded" generation investment. Other utilities have decided to focus their efforts on power generation and marketing.

Another business strategy is to remain vertically integrated and to offer an array of different utility products and services. Some utilities have reached the conclusion that they can best flourish in a competitive environment by getting larger and developing economies of scale. For this reason, the Commission has received numerous applications in recent years from utilities proposing classic "horizontal" combinations at the same level of the market (generation, transmission). Other merger applications reflect a recent trend toward "convergence" or "vertical" combinations between electric and natural gas utilities. I expect these trends to continue – indeed, accelerate – and I would not be surprised to see future convergences between electric utilities and other types of industries, such as telecommunications and Internet providers.

Finally, electric utilities are increasingly finding that it is in their best interest to cooperate voluntarily with their neighbors to develop regional institutions that promote reliable operation of, and non-discriminatory access to, the grid.

Who can best claim credit for these dramatic developments? To some extent, we regulators and legislators can. Congress can be quite proud of its legislative accomplishments, such as the Public Utility Regulatory Policies Act of 1978, that (despite unfortunate side-effects) introduced competition into the wholesale power supply market by encouraging the entry of non-traditional, independent power producers. Moreover, the Energy Policy Act of 1992 greatly accelerated the development of competitive markets by offering power suppliers additional ways to reach willing buyers. This Commission can be proud of its efforts in recent years – such as the promotion of non-discriminatory, open access transmission service – to ensure that the benefits of increased competition are not confined to only a few of the largest industry participants.

But, in my judgment, industry participants themselves deserve most of the credit for the restructuring of the industry and the competitive evolution of the market. Despite a reputation for conservatism, electric utilities have not been hesitant to adopt bold new strategies to take advantage of the opportunities that competition has to offer. Frankly, I have seen little industry resistance to the pro-competitive, open access policies initiated by federal and state legislators and regulators. To the contrary, I have been impressed by the degree of sophistication and innovation adopted by different utilities in different regions of the country to respond in different ways to competitive pressures and opportunities.

For this reason, I have been reluctant to call for sweeping federal energy restructuring legislation. And I have been reluctant to champion prescriptive, industry-

wide action by the Commission. My concern is that any such overreaching action will stifle the type of industry innovation and flexibility that has marked the last few years. New ideas and concepts for utility governance and operation are being brought to my attention every week. Some of them will flourish, and others will undoubtedly prove unacceptable. I have no grand design for the utility industry of the next millennium. I am extremely hesitant to support any major piece of legislation or rulemaking that would lock into place a 1999-vintage vision for the industry, when that vision might very well be overtaken by technological or other advances in future years.

Competition requires that industry participants enjoy the opportunity to take chances and, possibly, to make mistakes. But while I encourage risk-taking, and generally favor fewer layers of regulatory review rather than more, I remain mindful of the vital role that utility services provide in the everyday lives of the people of this nation. America's consumers and industries must remain confident that electric service will remain as reliable as ever. And all of the pro-competitive rhetoric of enlightened commentators and governmental officials will amount to nothing if the benefits of competition – through lower prices or increased product offerings – ultimately do not work their way down to **all** consumers.

In my judgment, H.R. 2944, taken as whole, does a very good job of threading the needle – allowing utilities to develop their own competitive business strategies, while ensuring that competitive miscalculations do not impair the reliable operation of the grid or limit the availability of low-cost energy service. I commend the Subcommittee for its

thoughtful and comprehensive review of the issues confronting the many participants in the marketplace, and its crafting of compromise legislation that represents a careful balance of various concerns and positions.

I continue to comment briefly on a few of the specific elements of the bill.

Mergers

I have already explained my belief that the pace of merger activity in the electric utility industry will not abate and, probably, will accelerate. I also expect new and different kinds of merger proposals, involving different kinds of business combinations, to be presented to the Commission.

I have expressed my concern on numerous occasions as to the pace of Commission review of the merger applications filed with us. I believe it would be inconsistent for the Commission to promote competition on the one hand, while on the other hand failing to respond in a timely and more predictable manner to the efforts of regulated utilities to restructure themselves in a manner that, in their judgment, is best able to respond and adapt to competitive realities. I hope that the possibility of delay or uncertainty in the review of merger applications does not act to inhibit corporate initiative and innovation.

I sense this same concern in the language of section 401 of H.R. 2944 that limits the time for Commission review to, at most, 240 days from the date of filing. At present, the Commission already is acting on the vast majority of merger applications within that time frame. Legislative language imposing a time cap will not affect in any significant manner the Commission's processing of the "easy" merger cases it receives for review.

It will, however, affect the Commission's review of harder cases. I suspect that the industry is increasingly exhausting the limited scope of potential mergers that present little concern for their effect on competition, rates and regulation, and will increasingly present to us mergers of larger utilities that will attract a significantly higher degree of opposition and analytical scrutiny. The Commission already has set two such merger applications – involving American Electric Power and Central and South West in one case, and Western Resources and Kansas City Power & Light in another – for hearing; those cases are awaiting decision by the administrative law judges and, ultimately, by the full Commission. The Commission will face similar pressure to set other large mergers – such as those recently proposed by Northern States and New Century in one recent announcement, and PECO and Commonwealth Edison in another – for lengthy, trial-type hearings.

A legislatively-mandated 240-day time cap for Commission decision effectively eliminates all but the most abbreviated of evidentiary hearings in merger cases. Many commentators undoubtedly will criticize the loss of procedural options currently available to the Commission; I, however, will not. Contested issues of policy and fact can, in almost all merger circumstances, be decided on the basis of the written pleadings filed for the Commission's consideration. While I am not attached to any single duration (180 days? 240? 365?) of any limitation, I do not find it unreasonable to expect the Commission to act in a time frame consistent with Congress' view as to the need for timely and predictable action.

As to the rest of section 401, which expands the Commission's merger authority in certain respects, I add my skepticism as to the need for Commission authority to consider the effect of any proposed merger on retail markets. This extension of authority appears to be counterproductive to the goal of more expeditious action on merger applications. The Commission has made it clear that it will consider the effect of a merger on retail competition if the applicable state commission articulates that it is without jurisdiction or lacks the ability to consider such retail competitive effects. In recent years, however, state commissions have refrained from asking the Commission to intercede in this area, and have demonstrated that they are quite competent to address the retail implications of proposed utility mergers. I see no reason to add an additional layer of regulatory review.

Regional Transmission Organizations

I find much to appreciate in section 103 of H.R. 2944, dealing with regional transmission organizations. Specifically, I appreciate its reference to encouraging utility innovation and individual design in the formation of RTOs. But I am deeply concerned by a mandate that compels filings by all utilities by January 1, 2002 and RTO participation by January 1, 2003.

I believe that the Commission already possesses sufficient authority under existing law to encourage transmission-owning utilities to cooperate **voluntarily** with their neighbors to advance regional solutions to lingering competitive and operational problems in wholesale power markets. I would much prefer to allow utilities to continue the rapid

pace of utility restructuring, and to work out among themselves and with their customers – with **encouragement** from the Commission or Congress rather than a legal directive – how best to design regional markets that serve **all** interests in an efficient and competitive manner.

The vast majority of transmission-owning utilities already are members of regional transmission institutions (in California, New England, New York, the Mid-Atlantic, the Midwest and most of Texas) or are actively engaged in discussions to form some such type of institution. These developing regional institutions are taking several different forms (most notably, for-profit transcos that own and operate transmission facilities, or not-for-profit independent system operators that do not own the facilities under their operational control). I support Congressional and Commission action that works to encourage this type of regional cooperation – especially with transmission-owning utilities that currently are not "public utilities" subject to the Commission's regulation and oversight. I suspect that transmission-owning utilities increasingly will find it difficult, from many different perspectives (reliability, business, etc.), to refrain from such cooperation. But I do not support Congressional or Commission action that, whether phrased subtlely or more overtly, makes the decision for utilities to turn over operational control of the transmission facilities they own to someone else.

For all of these reasons, I believe that a mandate to join a RTO by a date certain is unnecessary and ill-advised. In my judgment, the other provisions of section 103 give transmission-owning utilities all of the incentive they need to participate in a RTO of

their choosing. For example, the section on RTO independence (revised FPA section 202(h)(2)(A)) would afford utilities the discretion to design organizational structures that would allow market participants to retain passive, non-voting interests in the RTO, or own up to 10 percent of the voting interests in the RTO. This provision would allow for a great deal of innovation and flexibility among different types of RTOs in different regions of the country.

Moreover, I support initiatives of the type found in revised FPA section 202(h)(6), which would encourage the Commission to confer "incentive transmission pricing policies" on transmission-owning utilities which decide to participate in RTOs. If Commission-designed encouragement is sufficient, I doubt many utilities would be able to resist the type of incentive-based pricing policies that would operate as a lure to RTO entry.

Reliability

As I have already explained, **competition cannot be at the expense of reliability**. Historically, the critical matter of protecting the integrity of the electrical grid has been left in the first instance to the industry itself. The Commission has interceded when necessary to "keep the lights on" or, in recent years, to ensure that reliability-based operating practices do not interfere with the availability or quality of non-discriminatory open access transmission service.

I have been very impressed with the efforts of the North American Electric Reliability Council and the regional councils NERC administers to ensure the continued

integrity and reliability of the electrical grid. The electric utility industry and the customers it serves are in a much better position to assess and ensure the continued reliability of electric service than federal regulators lacking intimate familiarity with the details and complexities of remote transmission paths.

I have refrained from calling out for additional regulatory authority over reliability. Nevertheless, as wholesale power markets become increasingly competitive, and strains are imposed on the continuing reliability of the electrical grid planned and designed for a less competitive, more vertically-integrated environment, close cooperation with reliability organizations becomes imperative. For this reason, I have no objection to the language found in section 201 of H.R. 2944 that would clarify the Commission's oversight role by directing it to approve the formation and governance of a "self-regulating electric reliability organization" (ERO). Nor do I object to the Commission's review of mandatory reliability standards and its appellate-type review of implementation and enforcement disputes.

In addition, as electricity markets become increasingly competitive, close cooperation with state and local regulatory authorities with oversight over the reliability of local distribution facilities become imperative. For this reason, I have no objection to the language found in section 201 that would clarify the authority of states and local authorities to ensure the reliability of local distribution facilities. Because I am generally wary of additional layers of regulatory review that may add to uncertainty, I am very appreciative of the language of revised section 217(n) of the FPA that ensures that such

authority would not be exercised in a manner that could impair the reliability of bulk power systems.

My only hesitation with respect to the reliability provisions of H.R. 2944 would be the Commission's ability to entertain a much larger share of reliability-based issues and disputes, as envisioned in section 201, in light of its limited resources and general unfamiliarity with these issues (which might have to be decided in close to "real-time"). My hope is that the need for Commission intervention will be lessened by increasing respect for the mandatory rules of the EROs the Commission approves. And the availability of "incentive transmission pricing policies", referenced in section 103 of H.R. 2944, limited to transmission-owning participants in RTOs that act to promote reliable transmissions operations and encourage investment in and expansion of transmission facilities, should act as a significant incentive to minimize any reliability-based disputes.

Federal/State Jurisdiction

Finally, I am pleased to see legislative language in section 101 of H.R. 2944 that clarifies the now-murky boundaries between federal and state jurisdiction over different aspects of electricity supply and delivery. The clarifying language, for the most part, adopts the jurisdictional dividing lines adopted by the Commission in its Order No. 888 rulemaking; those lines, for the most part, have been accepted by industry participants and state regulatory commissions. I believe it is important, whenever possible, to eliminate jurisdictional turf battles and protracted court disputes over ambiguous

congressional delegations, in order to ensure that the benefits of increased competition flow through to consumers as quickly and comprehensively as possible.

In light of recent litigation on the subject of comparability of service, I would add one more clarification. That addition would clarify that the Commission's jurisdiction over unbundled transmission service is exclusive, and that the Commission retains the authority to protect against undue discrimination or preference in the provision of transmission service to all transmission users. Such clarification would codify existing Commission policy by allowing it to require that a transmission-owning utility offer transmission service to others that is comparable to (i.e., no worse than) the service it provides to itself.

Thank you for the opportunity to present my views on this important piece of federal legislation. I am happy to answer any questions you now may have.

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In recent years, the electric utility industry has undergone tremendous changes, primarily because of competition that has been unleashed by federal and state officials and accepted by industry participants. Competition requires that industry participants enjoy the opportunity to take chances and, possibly, to make mistakes. But while I encourage risk-taking, and generally favor fewer layers of regulatory review rather than more, I remain mindful of the vital role that utility services provide in the everyday lives of the people of this nation. America's consumers and industries must remain confident that electric service will remain as reliable as ever. And all of the pro-competitive rhetoric of enlightened commentators and governmental officials will amount to nothing if the benefits of competition – through lower prices or increased product offerings – ultimately do not work their way down to **all** consumers.

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Among the provisions of H.R. 2944, I support legislative initiative that would promote greater certainty and uniformity in the Commission's processing of **merger** applications. The section dealing with the development of **regional transmission organizations** is fine to the extent it encourages utility innovation and individual design, but I do not favor a legislative mandate that compels utility RTO filings and participation by a date certain. I generally support the section of H.R. 2944 that promotes close cooperation between the Commission, industry reliability organizations, and state and local authorities in ensuring the continued **reliability** of electrical operations. And I favor provisions of the bill that codify existing Commission policy as to the dividing lines between **federal and state jurisdiction** over electricity supply and delivery, and that alleviates confusion and continued uncertainty.